

**COMMONWEALTH OF MASSACHUSETTS  
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

**RE: PETITION OF BAY STATE GAS COMPANY  
TO INCUR LONG-TERM DEBT OF UP TO \$50,000,000**

**DTE 02-73**

**BRIEF OF LOCAL 273, UTILITY WORKERS UNION OF AMERICA**

**I. INTRODUCTION**

In accordance with the schedule established by the Hearing Officer on December 12, 2002, Local 273, Utility Workers Union of America, AFL-CIO ("Local 273") hereby submits its brief in this case.

On November 8, 2002, Bay State Gas Company ("Bay State" or "Company") submitted a petition, pursuant to G.L. c. 164, §§ 14 - 16, for approval to issue long-term debt in the amount of \$50 million and for a term of up to twenty years, at an interest rate of up to 7.75% per annum. Exh. BSG-1. The Company proposes to issue a promissory note to NiSource Finance Corporation ("NiSource Finance"), which, like Bay State, is a subsidiary of the parent company NiSource, Inc. Bay State also seeks a waiver from the requirements of G.L. c. 164, § 15 so that it need not put out to public bid the issuance of this debt but may instead issue the bonds to NiSource Finance.

The Attorney General submitted his notice of appearance in this case on December 3, 2002.

Local 273 submitted its petition to intervene on December 5, which the Company

opposed in a written filing on December 9, 2002. The Hearing Officer granted Local 273 limited participant status in a memo ruling issued on December 11, 2002.<sup>1</sup>

Southern Union Company petitioned for limited participant status on December 10, 2002, which status the Hearing Officer granted on December 12, 2002.

The Department held a public hearing on December 12, 2002, at which one member of the public spoke. Kevin Friary, president of Local 273, expressed Local 273's position that Bay State should not be allowed to issue bonds at the proposed terms of twenty years and up to 7.75% interest. He noted that the Company should be able to obtain more favorable rates.

Mr. Friary further stated that Nisource, Inc.:

... has taken a once-vibrant company and stripped it of all of its upper-level management positions . . . . In 1999 there were approximately 290 employees in [the] Westborough [headquarters]. Today there are approximately 20 employees left.

The position of president of Bay State Gas has been eliminated . . . . All of the support staff, accountants, sales, payroll, human resources . . . , they're all gone.

Bay State Gas Company for the past three years has made drastic cuts in its infrastructure investment . . . referring to Bay State Gas's main replacements.

The Department also conducted one day of evidentiary hearings on December 12, 2002.

The only witness to appear was Vincent Rea, assistant treasurer of Bay State Gas Company. The Department admitted into evidence the Company's petition; the testimony of Mr. Rea (with appended exhibits); and the responses to information requests propounded by the Attorney General, Local 273,<sup>2</sup> and the Department's staff.

---

<sup>1</sup> Local 273 appealed that ruling and filed a separate appeal brief on December 20, 2002.

<sup>2</sup> The record reflects that the Department marked responses "to its Information Requests 1 through 7 . . . as DTE-1 through DTE 1-7," and marked responses to Local 273's "Information Requests 1 through 20 as DTE-9 though 27." Tr. 13. Exhibit DTE-8 appears to have been inadvertently omitted, and it appears from other portions of the transcript that the Department marked Local 273's information requests as DTE-8 through DTE-27.

## II. STANDARD OF REVIEW

The Department has consistently articulated the standard of review that it applies to financing petitions submitted under G.L. c. 164, §§ 14 - 16, most recently in the cases of *Southern Union Company*, DTE 01-80 (2001), 2001 Mass. PUC LEXIS 90, and *Fitchburg Gas & Electric Light Company*, DTE 01-43 (2001):

First, the Department must assess that the proposed issuance is reasonably necessary to accomplish some legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14. [Citations omitted]. Second, the Department must determine whether the company has met the net plant test.

DTE 01-80, 2001 Mass. PUC LEXIS 90, at \*11 - 12.<sup>3</sup>

In circumstances in which the Department has not addressed:

the prudence of the company's capital financing . . . , the Department's determination in its [financing] Order may not in any way be construed as ruling on the appropriate ratemaking treatment to be accorded any costs associated with the proposed financing.

*Id.*, 2001 Mass PUC LEXIS 90, at \*13 - 14. *Accord, Fitchburg Gas & Electric Company, supra; see also Cambridge Electric Light Company v. DPU*, 333 Mass. 536, 538 - 539 (1956)

(Department has "distinct statutory duties to perform" under the financing laws, G.L. c. 164, §§ 14 et seq. and the rate-setting law, G.L. c. 164, § 94; ruling in financing case does not tie Department's hands as to ruling in subsequent rate case). This doctrine is relevant here because Local 273 urges the Department, *infra*, to explicitly rule that any approval of the \$50 million bond issuance "may not in any way be construed as ruling on the appropriate ratemaking treatment to be accorded [the interest] costs associated with the proposed [\$50 million] financing."

---

<sup>3</sup> Local 273 uses the LEXIS pagination because it does not have ready access to a hard copy of the decision in this case.

The Department has broad discretion to determine the scope and depth of its review in financing cases. In *Fitchburg Gas & Electric Light Company v. DPU*, 394 Mass. 671, 674 (1985), the Court reviewed the Department's conclusion that it had a:

clear obligation under G.L. c. 164, § 14, to make a determination as to the reasonableness both of the Seabrook construction program and the Company's continued participation in that project before approving any financings which will be used to support it.

(Internal quotations omitted). The Court rejected Fitchburg's argument that the Department cannot "deny long term financing needed for capitalizing utility plant in service" while it is investigating whether Fitchburg's "continued participation in the Seabrook project is . . . reasonably necessary." *Id.*, 394 Mass. at 676 - 677. The Court strongly affirmed the right of the Department to broadly investigate a utility's financial circumstances and project commitments in the context of a financing case:

[T]he department's duty under G.L. c. 164, § 14 goes well beyond a perfunctory review of a company's proposed financing. . . .

*The department has a range of discretion under the enabling legislation . . . . It also is the department's prerogative to determine whether an appropriate investigation entailed postponement of decisions in Fitchburg's financing requests until the decision in the generic proceeding [regarding the Seabrook construction program] was reached.*

*Id.*, 394 Mass. at 678, 680 (emphasis added). This decision affirms the right of the Department to postpone a decision in a financing case pending an investigation into the company's operations. While Local 273 is not asking the Department to delay a ruling on the financing petition, it does ask the Department to open up an investigation into the impacts that Bay State's merger with NiSource, Inc. has had on Bay State's financing needs and operations.

### **III. ARGUMENT**

**A. The Department Should Open an Investigation into and Management Audit of Bay State's Financial Condition and Operations**

Bay State Gas Company has been a troubled and declining company ever since its merger with NiSource, Inc. At the time of the merger, Bay State, through the testimony of James D. Simpson, promised the Department and the Company's ratepayers a broad range of financial and operational benefits. See *Bay State Gas Company et al.*, DTE 98-31 (Nov. 5, 1998) (discussing service quality, "financial integrity" and other advantages). In particular, the Company represented, and the Department found, that "Bay State's financial position is likely to improve" through its affiliation with NiSource. *Id.* at 48 - 49.

Events have proved to the contrary. Bay State's bonds have been downgraded three notches since its merger with NiSource (Tr. 50 - 51, 87 - 88, 93 -94), and ratepayers therefore bear a higher interest expense (Tr. 95). As the Department well-knows, Bay State has been "stripped of all of its upper-level management positions," with staffing at its corporate headquarters slashed from approximately 290 employees in 1999 to 20 employees today. Tr. 6. The sales Department has been virtually eliminated, affecting sales growth and the ability of new customers to get served. *Id.* Customer walk-in centers have all been closed. Local 273 has seen, first-hand, cutbacks in infrastructure investment. *Id.*

Local 273 cannot dispute that a number of previous Company financings have recently matured and that the Company needs to issue some form of new financing. However, consistent with the broad authority granted to the Department under Chapter 164 and court interpretations of that authority (*see, e.g., Fitchburg Gas & Electric Light Company v. DPU*, 394 Mass. 671 (1985), discussed *supra*), Local 273 calls upon the Department to open an investigation into and

management audit of the impact that the merger with NiSource, Inc. has had upon Bay State's costs and operations, including: financing costs (especially bond ratings and interest costs), replacement of old mains, installation of new mains and services, customer satisfaction and level of customer complaints, supervision of front-line staff (especially safety-related positions), and staffing levels. As the Supreme Judicial Court noted in the *Fitchburg* case, 394 Mass. 678, "the function of the department is the protection of public interests and not the promotion of private interests." To protect the public interest, including the safety and well-being of Bay State's employees and customers, Local 273 respectfully asks the Department to open the requested investigation.

Faced with similar staffing cutbacks and facilities closures as have occurred in Massachusetts, the Maine Public Utilities Commission seven months ago issued an "Order Initiating Management Audit and Investigation of Service Quality Incentive Plan." Me. PUC 2002-140 (May 16, 2002). In that Order,<sup>4</sup> the Maine PUC recounted facts that read as if they applied to Massachusetts and Bay State:

[I]n seeking approval [for a reorganization related to] the NiSource/Columbia merger, company officials represented that the merger would not result in any change in the management of Northern and Bay State or have any material impact on local operations of Northern . . . .

In approving the merger, we noted that customer service quality can suffer *when utility funds are short or when management's interest in this aspect of a utility subsidiary is diluted after a merger* . . . .

Subsequently, we became aware of call center performance problems that could not be successfully resolved by the [Consumer Assistance Division], a high level of estimated billing complaints, *and merger related staff cuts and local facilities closures* . . . .

---

<sup>4</sup> The full Order is available at <http://www.state.me.us/mpuc/orders/2002/2002-140o.htm>.

*We have become increasingly concerned, due to successive post-merger cuts in staffing levels and local facilities closures, with Northern's ability to provide adequate service in several other areas [apart from call center response], such as its capacity to respond to large scale outages and other service emergencies.*

... Northern's decision to *simultaneously close several walk-in centers* serving customers of Northern ... and its parent corporation, Bay State Gas (Bay State or BSG) ... *throughout Maine, New Hampshire and Massachusetts* ... caused renewed call center response problems ... [A]pproximately 5% of [Northern's] and BSG's customers, or approximately 17,000 customers in the three states combined, used the walk-in centers as their primary means of paying their bills.

(Emphasis added.)<sup>5</sup>

Massachusetts customers of Bay State deserve no lesser protection from the deleterious effects of Bay State's merger with NiSource than the Maine PUC has accorded Northern Utilities customers. The Company will no doubt protest that this is only a refinancing case and that this is not the appropriate vehicle to consider investigating or auditing its operations and management. The Department should not so vault form over substance that it foregoes protecting the interests of ratepayers. The time to act is now, before any serious and irremediable problems or incidents occur.<sup>6</sup>

**B. The Department Should Explicitly State That a Ruling in This Case "May Not in Any Way Be Construed as Ruling on the Appropriate Ratemaking**

---

<sup>5</sup> The web version of this Order does not allow for easy page references. The cited language comes from: "II, Background," II.A, Service Quality Monitoring," "IV.A, Basis for Regulatory Action," and "V.A.1., "Chronology of Events - Overview."

<sup>6</sup> The Department clearly has the authority to open such an investigation on its own authority. G.L. c. 164, § 76; *Fitchburg, supra*, 394 Mass. at 678 - 680.

**Treatment to Be Accorded” the Interest “Costs Associated with the Proposed Financing,”**

Past Department and court precedents, discussed under the “Standard of Review,” *supra*, establish that a ruling in the present case cannot be construed as an advance ruling on the appropriate ratemaking treatment to be accorded the interest costs that the Company will incur. The Department should explicitly so state in its order, given the strong evidence that Bay State’s interest costs have gone up as a result of its merger with NiSource. Massachusetts ratepayers cannot be saddled with the collateral costs of NiSource’s investment decisions, especially its decision to purchase Columbia Energy.

Bay State used to be a much higher rated company, at least three notches higher based on the testimony in this case. Tr. 47 - 48 (discussing “notching differential” between Bay State and NiSource, “going back two to three years”);<sup>7</sup> Tr. 50 - 51 (Bay State used to have a rating “two to three notches” higher than NiSource; those ratings have now converged). The downgrading of Bay State’s ratings are directly attributable to its merger with NiSource. Tr. 88 (Moody’s downgrade of Bay State was three notches, resulting from NiSource’s financial position.). When asked if “Bay State’s bond ratings are lower than they would have been if Bay State had not merged with NiSource,” Bay State’s witness replied: “I think there’s some truth to that statement, yes.” Tr. 93 - 94. Finally, there is no question that these “lower ratings translate into higher costs of capital for Bay State.” Tr. 94 -95.

The record thus clearly establishes that Bay State’s bond ratings have fallen significantly

---

<sup>7</sup> Local 273 had requested ratings information going back five years, in order to develop this point more fully, but Bay State provided only current bond ratings. See Exh. DTE-12 (response to IR Union 1-5).



since its merger with NiSource, due to NiSource's (not Bay State's) financial weaknesses. These lower bond ratings translate into higher costs for ratepayers. The Department must carry out its obligations to protect "public interests" rather than promote "private interests," as mandated by statute and court cases. *Fitchburg, supra*, 394 Mass. 671, at 678. In relation to the Company's pending financing request, the only way to do so is to determine the additional interest costs that Bay State will incur as a result of its merger with NiSource. Local 273 does not suggest that the Department can do so in the confines of the present case, but it can and should do so in some future rate case or other proceeding. Therefore, Local 273 asks the Department to specifically rule that any financing approval in this case may not be construed as a ruling on the appropriate ratemaking treatment to be accorded the bond-related interest costs in any future proceeding. *Southern Union Company*, DTE 01-80, 2001 Mass PUC LEXIS 90, at \*13 - 14.

**C. The Department Should Address the "Regulatory Ringfencing" Problems Cited by NiSource's Bond Rating Agencies**

All of the agencies that rate the debt instruments of NiSource and its operating subsidiaries contrast the relative weakness of the parent company with the relative strength of the operating subsidiaries. See response to IR AG 1-7 (Exh. AG 1-7, ratings of Fitch, Moody's and Standard & Poor's). In February of this year, Moody's downgraded Bay State by three notches and Columbia Energy and NIPSCO by two notches. Moody's commented that these downgradings:

align the ratings of the subsidiaries and bring them closer to the parent's rating. *The change in notching reflects the subsidiaries' financial and operational integration with the parent and lack of regulatory ringfencing.*

Exh. AG 1-7, Moody's Ratings, "Moody's Downgrades NiSource, Inc. - Outlook Remains Negative," p. 2 of 2 (Feb. 1, 2002). Similarly, Standard & Poor's commented on January 17, 2002:

Although the operating companies' financial profiles are much stronger than that of NiSource, Standard and Poor's views the default risk the same throughout the organization because *there are no regulatory mechanisms or other structural barriers in NiSource's nine-state service territory that sufficiently restrict access by the holding company to the cash flow of any of its utilities.*

Exh. AG 1-7, Standard & Poor's Ratings, "S&P Affirms NiSource Ratings," p. 1 (Jan. 17, 2002).

The ratings agencies agree that NiSource's operating subsidiaries cannot maintain ratings higher than NiSource's own rating, despite their "stronger financial profiles," because there are not sufficient "mechanisms" in place to stop NiSource from accessing the cash generated by the operating companies. Bay State's witness agrees:

that there's no way to put a ring around Bay State Gas or other operating subsidiaries to say that these assets are going to be protected and these cash flows are going to be protected from the parent company.

Tr. 89 - 90. There is no question but that NiSource's investment in the merger with Columbia has dragged the parent company down financially and that these problems flow through to Bay State. Tr. 86, 87 (NiSource's \$8 billion in debt affects ratings of all NiSource companies).

In connection with the investigation that Local 273 has asked the Department to open, *supra*, the Department should also investigate methods of protecting the Company's ratepayers from the deleterious effects of the Company's merger with NiSource, including the lack of "regulatory ringfencing" and "regulatory mechanisms" that would preserve Bay State's cash for serving the needs Bay State's ratepayers.

**D. The Department Should Not Allow Bay State to Issue 20-Year Bonds**

Bay State has already modified its initial proposal to issue 20-year bonds at an interest rate of up to 7.75% and now proposes to issue 10-year bonds at up to 6.75% interest. Tr. 16 -17, 53. This 100-basis point reduction in the interest rate reduces the ten-year interest cost by \$5,000,000. Tr. 77 (reduction of 10 basis points reduces interest cost \$50,000 per year; a 100-basis point reduction would reduce the cost by \$500,000 per year, or by \$5,000,000 over ten years). In light of the Company's new proposal and the current yield spreads at various bond durations, the Department should not allow Bay State to issue 20-year bonds.

**E. The Company Has Made an Insufficient "Public Interest" Showing to Obtain a Waiver Under G.L. 164, §15.**

G. L. c. 164, § 15 governs the issuance of bonds and generally requires the company offering bonds to "invite proposals for the purchase thereof." However, under § 15:

The department may grant an exemption from part or all of the requirements of this section whenever it finds after a public hearing that the granting of such exemption is in the public interest.

The Company seeks such an exemption here, but it offers a weak record for the Department so granting.

The company is clearly engaged in self-dealing. There were no arms-length negotiations among distinct parties. In fact it appears that there were no discussions at all between individuals purporting to represent the interests of Bay State and NiSource Finance, respectively. Company witness Vincent Rea, who essentially conceived and designed the proposed financing, holds positions with NiSource Corporate Services, Bay State, NiSource Finance, and thirty other

NiSource operating subsidiaries. Tr. 14, 21 - 22;. Exh. DTE-9 (IR Union 1-2). Mr. Rea apparently determined solely on his own that “a note issued to NiSource Finance Corp. would be the most cost-effective approach” to address the Company’s financing needs.

The Company’s proposed methods for setting the ultimate interest rate on the loan are neither transparent nor readily verifiable. In response to the Attorney General’s information request that Bay State provide “a complete and detailed description of the methodology that will be used to determine the interest rate associated with the promissory note,” the Company provided nothing more than this:

“20 year Treasury Bond rate plus NiSource’s spread over the 20 year Treasury Bond.” Exh. AG 1-10. In this answer, the Company explained neither how it would determine the “20 year Treasury Bond rate,” nor “NiSource’s spread” over that rate. See Tr. 34 - 35. When asked in person to explain how he would “determine the 20-year Treasury bond rate,” or the 10-year rate, if the Company issues a ten year bond, the witness gave several long answers that referenced a number of different sources, including Bloomberg, “two, three, four different investment banks,” and the Federal Reserve. Tr. 36 - 41. It is simply not clear how the Department will determine which source the Company will use, and whether that source is an appropriate one.

The spread that the Company will add to the Treasury rate is even harder to determine. Apparently, the Company will obtain free, informal advice from investment bankers who are eager to solicit the NiSource’s business in the future. Tr. 41 (the underwriters who provide this advice “will not be compensated in any way, shape or form”). As Mr. Rea himself noted, the “corporate risk spread [over T-bills] varies significantly over time” Tr. 37 (referring to yield spread changes over many years). More germane to the Company’s request to dispense with

public bidding, those yield spread vary significantly even over the course of a few weeks. Tr. 38 (“just over the past four to six weeks or so the spreads that we would pay . . . have improved dramatically”); see also Exh. DTE-15 (response to IR Union 1-8) (attached e-mails show yield spreads changing on a daily basis). Thus, the Company asks the Department to waive public bidding and instead rely on an interest-setting formula that includes a highly-variable and hard-to-asertain term (current yield spreads).

There are several other reasons why the Department should be wary of approving Bay State’s requested waiver. First, to the extent that Bay State’s proposed methodology results in interest rates that are higher than a public bid process would produce, the excess interest payments come at the expense of ratepayers and flow directly to NiSource’s bottom line. Tr. 81, l. 20 - Tr. 82, l. 5. Second, current yield spreads are large, perhaps 265 to 270 basis points on a 10-year bond (as of the time of the hearing). Tr. 135. In the past, the yield spreads were much smaller. Exh. DTE-17 (response to Union 1-10), corrected by DTE-RR-1, “Amended Response” (yield spreads between Treasury rate and corporate notes range from a maximum of 99 basis points [“Notes Due 2005”] to as little as 37 basis points [“Notes Due 2028”]; see also Tr. 97 - 98. The Department should not simply accept the Company’s representations that its proposed yield spread of 265 or more basis points is a better result than public bidding would provide. Third, it is not clear that even the lower 6.75% rate for the 10-year bonds now proposed is a favorable rate. In a schedule prepared by the Company of bonds issued as recently as October 2002, the longest-term utility and energy bonds listed have a maturity of thirty years, yet carry an interest rate of only 5.9% and 6.45%, measurably below the 6.75% that the Company proposes for its 10-year bonds. Tr. 96 - 97, referring to DTE-15 (response to IR Union 1-8, listings for Duke Energy

and ConocoPhillips). While Duke Energy and Conoco have much higher bond ratings, the fact that these 30-year bonds carry lower interest rates than the Company's proposed 10-year bonds raises serious questions about the Company's "public interest" waiver request.

Local 273 does not challenge the concept that a loan between affiliated companies can, in some circumstances, result in lower interest costs and promote the public interest. However, the Company has made a very weak showing in support of its request to waive the requirements of G. L. c. 164, § 15. Factors that supported the grant of public interest waivers in other cases are not present here. *See, e.g., Fitchburg Gas and Electric Company*, DTE 01-43 (2001), 2001 Mass. PUC LEXIS 48, at \*11 (Department approves § 15 waiver and private placement where private "institutional investors" were solicited "through a competitive process"); *Southern Union Company*, DTE 01-80 (2001), 2001 Mass. PUC LEXIS 90, at \*26 (Department grants § 15 waiver where "ultimate interest rate of the notes payable . . . would depend upon the yield" on securities "placed in the market on a competitive basis.").

The Department must adhere to the requirements of § 15 and grant a waiver only if the Company demonstrates that this is in the "public interest." Local 273 does not see that the Company has made such a showing on the record before the Department. Should the Department grant Bay State a waiver from § 15, it should do so only on several conditions. First, the Company should be required to file with all parties full and complete documentation, including all source materials, for how it determined the relevant Treasury rate and, separately, how it determined the appropriate yield spread. Second, it should provide a contemporaneous update of its response to IR Union 1-8 (Exh. DTE-15) so that the Department may be able to compare the Company's interest rate to interest rates of other recent bonds. Third, the interest rate must be

subject to downward (but not upward) revision so that it does not exceed the interest rate of the next issuance of bonds by NiSource Finance. The Department should state that nothing in the granting of the waiver may be construed as a ruling on the appropriate ratemaking treatment of the bond interest expense. Further, the granting of any waiver should be conditioned upon the opening of the investigation and audit requested by Local 273, *supra*.

#### **IV. CONCLUSION**

Local 273 respectfully asks the Department to open an investigation into the financial condition and operations of Bay State Gas Company; to explicitly hold that any ruling in this case cannot be construed as a ruling on the appropriate treatment to be accorded the bond-related interest expenses in any future rate case or other proceeding; to address the “regulatory ringfencing” problems identified in reports of the Company’s rating agencies; and to issue such other orders as are consistent with the arguments above.

Respectfully Submitted,

Charles Harak, Esq.  
77 Summer Street, 10<sup>th</sup> floor  
Boston, MA 02110  
617 988-0600 (ph)  
617 523-7398 (fax)  
charak@nclc.org

DATED: December 23, 2002